

Office of Chief Counsel
Internal Revenue Service

memorandum

CC: LM: [REDACTED]: TL-N-1826-99
[REDACTED]

date: June 13, 2001

to: Team Manager, Team [REDACTED]
Mail Stop [REDACTED]

from: [REDACTED]
Special Litigation
Assistant (LMSB)

subject: [REDACTED] I.R.C. § 482 transfer of services issue
UIL Nos.: 482.09-00 Services; 482.09-03 Integral Part of Business

This memorandum is in response to your request for an analysis of a proposed adjustment to the taxpayer's gross income under I.R.C. § 482 for the transfer of technical services from members of the consolidated group to foreign affiliates. Specifically, on June 1, 2001, this office was asked to review a draft document entitled "working paper," which would serve as the foundation for the proposed adjustment, as well as review approximately fifty documents received from the taxpayer by the examination team on [REDACTED], regarding technical services provided by [REDACTED], to [REDACTED], beginning [REDACTED]. This memorandum should not be cited as precedent.

ISSUE and SUMMARY CONCLUSION

Whether an adjustment to the taxpayer's gross income under I.R.C. § 482 is warranted due to the transfer of technical services to foreign affiliates for less than an arm's length charge. We conclude that an adjustment is not warranted.

FACTS

[REDACTED] is a wholly-owned United States subsidiary of [REDACTED]. [REDACTED] administers the [REDACTED] portion of [REDACTED]'s cooperative research effort, which is known as the [REDACTED]. Members of the [REDACTED] bear the costs of [REDACTED]'s general research. Direct research applications for projects not part of the general research pool are billed directly at cost to members and non-members. Non-members are subject to a potential "technology fee."

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is a division of founded in . bears 's share of expenses under the . provides advice and services to 's 's businesses worldwide as well as services.

and 's operations are contrasted on page 12 of the working paper. provides contract services under the moniker "research application" to affiliates and others worldwide. serves as the primary and manager of activity for the entire group of group of companies. On occasion, will use as a contractor for some applications, but reserves an expanding role, for itself as a service provider.

Total research application billings issued by increased from \$ in to \$ in . represented from to % of those billings. In contrast, 's inter-company billings increased from \$ in to \$ in . billed foreign affiliates over \$ for years for services, more than times as much as it billed companies active in the United States.

One of the third parties which provided services for during was .

In , the shareholders were in discussions with the , who wanted the companies to provide a certain level of assistance after the transfer to . In a theme that would be repeated over the next several years, the sticking point of the negotiations was the amount of the "fee" to be paid and the purpose for the "fee." It appears that the fee was always expected to be an amount beyond the cost of the companies to provide the services. The expressed an interest in keeping the fee " ," which would appear to mean justifiable with respect to the value of the services performed, while the companies wanted a fixed fee which would " . In effect, the companies saw the fee as a payment for which would be ready to meet the demands for services, a sort of retainer.

After considerable negotiations, and the companies, which formed a partnership referred to as , settled upon a \$ annual fee in addition to times salary and payroll

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burden for technical services and [REDACTED] times salary and benefits for employee "[REDACTED]," effective from [REDACTED] through [REDACTED]. The amount of the annual fee was negotiated downward to \$ [REDACTED] for [REDACTED] and [REDACTED] and further reduced to \$ [REDACTED] for [REDACTED] through [REDACTED]. Other aspects of the arrangement, known as the [REDACTED], remained essentially the same.

DISCUSSION

According to page 13 of the working paper, [REDACTED] charges all services to affiliates at "cost," and thus claims that the services provided by [REDACTED] and [REDACTED] meet the "safe harbor" provision of Treas. Reg. § 1.482-2(b)(3). (An exception of unknown consequence is the "[REDACTED]" charged by [REDACTED] to non-members of the [REDACTED].)

An arm's length charge shall not be deemed equal to costs or deductions with respect to services which are an integral part of the business activity of either the renderer or the recipient of the services. Treas. Reg. §§ 1.482-2(b)(7)(i) through (b)(7)(iv) describe situations in which services shall be considered an integral part of the business activity of a member of a group of controlled entities.

Under Treas. Reg. § 1.482-2(b)(7)(i), services are an integral part of the business activity of a member of a controlled group where either the renderer or the recipient is engaged in the trade or business of rendering similar services to one or more unrelated parties. (It was noted in a [REDACTED] [REDACTED] that none of the [REDACTED] partners are in the business of providing technical assistance to third parties and that the arrangement with [REDACTED] was unique.)

Under Treas. Reg. § 1.482-2(b)(7)(iii), services are an integral part of the business activity of a member of a controlled group where the renderer is peculiarly capable of rendering the services and such services are a principal element in the operations of the recipient. This provision is the focus of the [REDACTED].

Although not specifically mentioned in the [REDACTED], it appears that the [REDACTED] documents would be expected to provide much of the support for the argument that [REDACTED] is peculiarly capable of rendering the services provided. (b)(5)(AC)

[REDACTED] See [REDACTED] (pp. [REDACTED]); [REDACTED] (pp. [REDACTED]);

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and [REDACTED] pp. [REDACTED]) discussions.

The fact of the matter is that the [REDACTED] documents, while marginally supportive of a "peculiarly capable" argument, are not sufficiently so for the following reasons:

1. Difference in renderer. The services are being performed under the [REDACTED], not by [REDACTED] alone. [REDACTED] would lack the synergy of the [REDACTED] partners, and [REDACTED] itself apparently doesn't have anything to do with [REDACTED]. (b)(5)(AC) [REDACTED]

2. Difference in services rendered. The services are being performed by [REDACTED] with respect to [REDACTED] in [REDACTED]. (b)(5)(AC)

3. Allocation of fee. The fee is not shared by the [REDACTED] partners solely on the level of their contributions, but at least partially on the basis of their equity positions, [REDACTED]

4. Purpose of fee. (b)(5)(AC)

5. Waning peculiarity.

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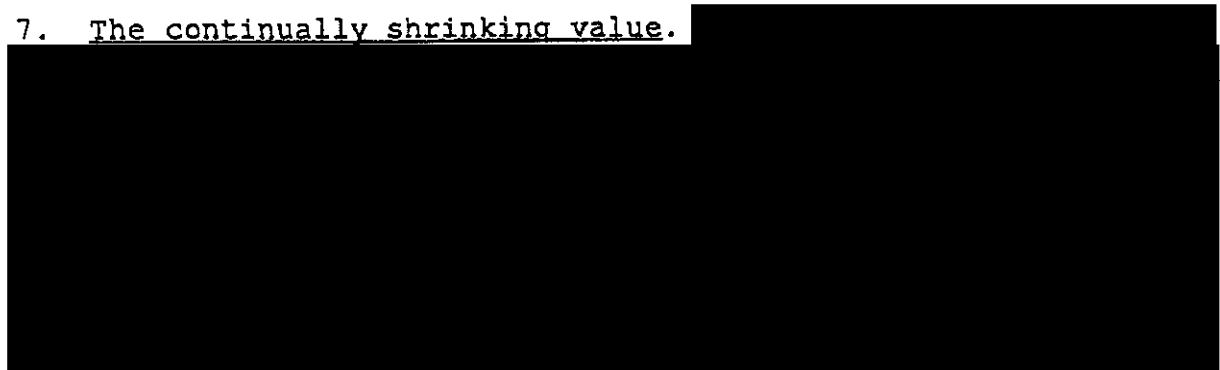
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6. Value of services not substantially in excess of costs or deductions of the renderer.



7. The continually shrinking value.



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[REDACTED]

8. [REDACTED] partners begin to show different attitudes about fee level.

[REDACTED]

[REDACTED]

[REDACTED]

(b)(5)(AC), (b)(5)(AWP)

[REDACTED]

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a. (b)(5)(AC)
[REDACTED]b. (b)(5)(AC)
[REDACTED]c. (b)(5)(AC)
[REDACTED]d. (b)(5)(AC)
[REDACTED]e. (b)(5)(AC)
[REDACTED]f. (b)(5)(AC)
[REDACTED]

The challenge would be to try to determine the amount of an arm's length charge for the service provided to affiliates by [REDACTED] and [REDACTED]. (b)(5)(AC) [REDACTED];

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(i) (b)(5)(AC) [REDACTED]

(ii) [REDACTED];

(iii) [REDACTED];

(iv) [REDACTED]; and

(v) [REDACTED]

CONCLUSION

After considering the documentation and arguments presented to date, it is the recommendation of this office that the proposed section 482 transfer of services issue not be included as an adjustment to the revenue agent's report for [REDACTED]. While reasonable opinions may differ, it is very unlikely that the peculiarly capable characterization of the services could be achieved. (b)(5)(AC) [REDACTED]

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[REDACTED]

Special Litigation
Assistant (LMSB)

APPROVED:

[REDACTED]

Area Counsel
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